United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

74-1012

No. 74-1012

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 74-1012

LEON-SEGAN,

Plaintiff-Appellant,

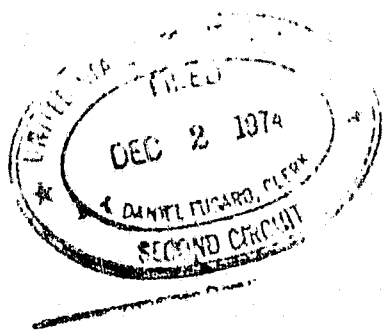
v.

DREYFUS CORPORATION, DREYFUS MARINE MIDLAND BANK, INC., DREYFUS MARINE MIDLAND MANAGEMENT CORP., INTERNATIONAL TELEPHONE AND TELEGRAPH CORPORATION, LAZARD FRERES & CO., HOWARD STEIN, RICHARD A.M.C. JOHNSON, JULIAN M. SMERLING, LAWRENCE M. GREENE, FELIX G. ROHATYN, ANDRE MEYER, and THE DREYFUS FUND, INC.,

Defendants-Appellees.

Appeal from the United States District Court
for the Southern District of New York

BRIEF OF DEFENDANT-APPELLEE
INTERNATIONAL TELEPHONE AND TELEGRAPH CORPORATION



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Dated: December 1, 1974

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STATEMENT OF THE ISSUES PRESENTED FOR REVIEW

Whether the District Court correctly held that the particularity requirement of Rule 9(b) of the Federal Rules of Civil Procedure, as construed by this Court in Segal v. Gordon, 467 F.2d 602 (1972), and other cases, is not satisfied by a complaint which, with one exception, fails to identify or describe any of the transactions alleged to be fraudulent.

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v.

DREYFUS CORPORATION, DREYFUS MARINE MIDLAND BANK, INC., DREYFUS MARINE MIDLAND MANAGEMENT CORP., INTERNATIONAL TELEPHONE AND TELEGRAPH CORPORATION, LAZARD FRERES & CO., HOWARD STEIN, RICHARD A.M.C. JOHNSON, JULIAN M. SMERLING, LAWRENCE M. GREENE, FELIX G. ROHATYN, ANDRE MEYER, and THE DREYFUS FUND, INC.,

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Appeal from the United States District Court
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BRIEF OF DEFENDANT-APPELLEE INTERNATIONAL TELEPHONE AND TELEGRAPH CORPORATION

STATEMENT OF THE CASE [1/]

This is a derivative suit, instituted some two and one-half years ago by a shareholder of the Dreyfus

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1/ The pertinent facts and proceedings are more fully described in the brief submitted in this case on behalf of defendants-appellees Dreyfus Corporation, Stein, Johnson, Smerling and Greene. The factual statement included here is intended merely to draw the Court's attention to the most important aspects of the proceedings before the District Court.

Fund. Plaintiff-appellant alleges in broad and conclusory terms that the defendants, other than the Dreyfus Fund, have since 1969 engaged in a continuing scheme to defraud the Fund. This appeal was taken from two interrelated orders of the District Court (Cannella, J.). On May 11, 1973, the District Court held that the vague terms of plaintiff's complaint failed to satisfy the particularity requirement of Rule 9(b) of the Federal Rules of Civil Procedure and directed plaintiff to file a more definite statement of his claims. (A63-65.) Plaintiff insisted that he had sufficient information to comply with the District Court's order, but he declined to do so. (A90-91.) Instead, plaintiff sought to engage in elaborate discovery, evidently designed to find support for the vague and conclusory allegations of the complaint. (A94-148.) On October 25, 1973, more than five months after its original order, the District Court dismissed the complaint without prejudice, on the ground that plaintiff had refused to file a more definite statement. (A90-91.) This appeal followed.

This suit was stimulated by a series of articles that appeared in the New York Times in March and April, 1972. (A153, 160-61.) The articles stated that ITT,

in an effort to obtain a favorable tax ruling in connection with its proposed affiliation with Hartford Fire Insurance Company ("Hartford Fire"), had sold shares of Hartford Fire common stock to Mediobanca S.p.A., a large Italian bank. The articles averred that the contract of sale guaranteed Mediobanca against loss on any subsequent resale. The articles claimed that, after the Hartford Fire shares had been exchanged for shares of ITT preferred stock in an ITT-Hartford Fire exchange offer, Dreyfus Corporation purchased certain of the shares from Mediobanca on behalf of Dreyfus Fund, thereby relieving ITT of any further obligations to Mediobanca. The articles speculated that ITT rewarded Dreyfus Corporation by permitting Dreyfus Marine Midland Management Corporation to manage the investment of certain ITT pension funds.

Plaintiff's complaint was filed a few days after the appearance of the last of the Times stories. The complaint was not, however, limited to the speculations contained in the Times stories. The complaint instead included broad allegations of systematic fraud over a three-year period. (A11-12.)[2/] Plaintiff alleged that the

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2/ All references in this brief to plaintiff's complaint are made to the amended complaint, set forth at pages A7-21 of the Appendix.

defendants had since 1969 engaged in a continuing series of fraudulent transactions, each of which was intended to deprive Dreyfus Fund of profits, opportunities and advantages. Plaintiff charged certain of the defendants with personal misconduct and a breach of fiduciary duty. (A12.) The alleged transaction involving ITT and Mediobanca was offered merely as a "typical" illustration of defendants' allegedly fraudulent methods and activities. (A35.)

Following the filing of the complaint, Lazard Freres and other defendants took plaintiff's oral deposition in an effort to ascertain the claims that plaintiff seeks to assert through the complaint's vague and general terms. (A149-203.) The effort was wholly unsuccessful. Plaintiff acknowledged his reliance upon the Times stories, but also claimed that the complaint was based upon an investigation conducted by counsel. (A152, 162, 181, 188.) At counsel's direction, however, plaintiff declined to provide any information regarding the results of the alleged investigation, relying upon the attorney-client and work product privileges. (E.g., A156, 162, 163, 164.) Despite the repeated protests of counsel for Lazard Freres that he sought only to ascertain any facts that plaintiff

might have to support or clarify the complaint (e.g., A164, 165), plaintiff declined to provide any additional information.

As set forth above, the District Court held on May 11, 1973, that the complaint's "broad and conclusory allegations" (A64) fail to satisfy the requirements of Rule 9(b), and ordered plaintiff to file a more definite statement of his claims. On October 25, 1973, the District Court held that plaintiff is not entitled to engage in discovery in search of support for "an infirm complaint" (A91), and dismissed the action without prejudice. The District Court emphasized that plaintiff had taken the position that, although he had sufficient information to comply with the order of May 11, 1973, he refused to do so unless he was first permitted to engage in an "unwarranted exploration of the defendants' businesses and affairs . . . ." (A91.)

ARGUMENT[3/]

I.

Plaintiff's complaint fails to satisfy the requirements of Rule 9(b).

Rule 9(b) provides in pertinent part that "[i]n all averments of fraud or mistake, the circumstances

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3/ The reasons and authorities that require affirmance of the judgment entered below are more fully set forth in the brief filed in this case on behalf of defendants Dreyfus Corporation, Stein, Johnson, Smerling and Greene.

constituting fraud or mistake shall be stated with particularity." The rule represents a long-standing requirement of the law, strongly supported by important considerations of policy. As we show below, the District Court properly found that, consistent with the instructions of this Court in Segal v. Gordon, 467 F.2d 602 (1972), and other cases, plaintiff's complaint fails to satisfy Rule 9(b).

A. The origins and purposes of the particularity requirement.

Rule 9(b) is merely a restatement of the well-settled rule at common law that allegations of fraud must be pleaded with particularity. E.g., Stearns v. Page, 7 How. 818 (1849); Duane v. Altenburg, 297 F.2d 515, 518 (7th Cir. 1962); Chicago T.&T. Co. v. Fox Theatres Corp., 182 F. Supp. 18, 31 (S.D.N.Y. 1960). The Supreme Court emphasized more than 125 years ago that unless "stringent rules of pleading and evidence" are applied to claims of fraud, "no man's property or reputation would be safe." Stearns v. Page, supra at 829. The Court has consistently held that, in accordance with the common law rule, claims of fraud must

> "state distinctly the particular acts of fraud and coercion relied on, specifying by whom and in what manner they were perpetrated, with such definiteness and

reasonable certainty that the court might see that, if proved, they would warrant . . . [relief]." Chamberlain Machine Works v. United States, 270 U.S. 347, 349 (1926).

Important considerations of policy support the strict application of the particularity requirement. Hasty and unsupported allegations of fraud may have severe consequences. The reputations and business activities of those who are accused may be irreparably damaged. Such allegations are particularly injurious to those who, like several of the present defendants, are engaged in businesses requiring the performance of fiduciary duties. In light of their potentially harmful consequences, it is "just and proper" that fraud claims be permitted only if they are made with a high degree of specificity. Dixie Mercerizing Co. v. Triangle Thread Mills, 17 F.R.D. 8, 9 (S.D.N.Y. 1955). See generally Segal v. Gordon, supra at 607; 5 C. Wright & A. Miller, Federal Practice and Procedure §§ 1296, 1298 (1969).

B. Rule 9(b) should be strictly applied.

Consistent with the origins and purposes of the particularity requirement, this and other courts have rigorously applied Rule 9(b). It has repeatedly been held that "[m]ere conclusory allegations to the effect

that defendant's conduct was fraudulent . . . are insufficient." Shemtob v. Shearson, Hammill & Co., 448 F.2d 442, 444 (2d Cir. 1971). "[T]here must be allegations of facts amounting to deception in one form or another; conclusory allegations of deception or fraud will not suffice." O'Neill v. Maytag, 339 F.2d 764, 768 (2d Cir. 1964). "The circumstances constituting fraud must be set forth in detail or the allegation cannot be permitted to stand." Dixie Mercerizing Co. v. Triangle Thread Mills, supra at 9. Bare allegations of fraud, "without the conjoint allegation of substantiating details," are inadequate. Id. at 10. "[T]he facts which constitute the fraud must be pleaded." Loew's Inc. v. Makinson, 10 F.R.D. 36, 37 (N.D. Ohio 1950). "Facts must be alleged which, if proven, would constitute fraud or which lead clearly to the conclusion that fraud has been committed." Chicago T.&T. Co. v. Fox Theatres Corp., supra at 31.

In Segal v. Gordon, supra, this Court carefully reviewed the origins and scope of the particularity requirement, and reemphasized the strict application of Rule 9(b) to securities fraud cases. The Court observed that the

particularity requirement is intended both to discourage strike suits, including those in the form of shareholders' derivative actions, and to shield defendants against unwarranted injuries to their reputations. Id. at 607. It held that broad and conclusory allegations of fraud, such as those made here, cannot satisfy the requirements of Rule 9(b). It made clear that a fraud complaint "should serve to seek redress for a wrong, not to find one." Id. at 608.[4/]

C. Plaintiff's complaint does not assert his claims of fraud with reasonable particularity.

Plaintiff's complaint obviously does not satisfy the rigorous requirements stated in Segal and numerous other cases. The alleged ITT-Mediobanca transaction is offered merely as a "typical" example of the continuing pattern of defendants' methods and activities. Apart

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4/ The principles applied by this Court in Segal v. Gordon, supra, have of course been stated in numerous other cases. In addition to the cases cited in the text above, see, for example, Seward v. Hammond, 8 F.R.D. 457 (D. Mass. 1948); C.I.T. Fin. Corp. v. Sachs, 10 F.R.D. 397, 398 (S.D.N.Y. 1950); Producers Releasing Corp. v. Pathe Indus., 10 F.R.D. 29, 32 (S.D.N.Y. 1950); Robison v. Caster, 356 F.2d 924, 925 (7th Cir. 1966); Perma Research & Dev. Co. v. Singer Co., 410 F.2d 572, 576 (2d Cir. 1969); Schonholtz v. American Stock Exchange, 376 F. Supp. 1089, 1091 (S.D.N.Y. 1974). Moreover, Segal itself has been frequently followed and applied. E.g., Spiegler v. Wills, 60 F.R.D. 681 (S.D.N.Y. 1973); Goodall v. Columbia Ventures, 374 F. Supp. 1324, 1333 (S.D.N.Y. 1974); Lewis v. Varnes, 368 F. Supp. 45 (S.D.N.Y. 1974); Passerieux v. Time, Inc., 1974 Sec. L. Rep. ¶ 94,805 (S.D. N.Y. 1974); Goldberg v. Shapiro, 1974 Sec. L. Rep. ¶ 94,813 (S.D.N.Y. 1974).

from the description of that transaction, plaintiff's allegations of fraud are vague and conclusory. Plaintiff does not trouble to identify, even in the most general terms, any of the other transactions that are alleged to have occurred. No facts are alleged "which, if proven, would constitute fraud or . . . lead clearly to the conclusion that fraud has been committed." Chicago T.&T. Co. v. Fox Theatres Corp., supra at 31. Plaintiff is content merely to trace the general provisions of the federal securities laws.

Even if the complaint were limited to allegations involving the alleged ITT-Mediobanca transaction, it would not satisfy the stringent requirements of Rule 9(b). Despite the rule's requirements, the complaint does not, with respect to ITT, contain "allegations of facts amounting to deception." O'Neill v. Maytag, supra at 768. Nothing in paragraph 21, the only paragraph in which the transaction is described, suggests that ITT participated in any way in the alleged purchase of shares by Dreyfus Fund from Mediobanca. (A14.) No claim is made that before the sale ITT was party to, or even aware of, any arrangement under which Dreyfus Marine Midland Management Corporation or any other person would be rewarded with the

management of ITT pension funds. Nothing in the paragraph alleges that the price paid to Mediobanca by Dreyfus Fund for the shares was unreasonably high.

Even if read generously, paragraph 21 alleges nothing more than that ITT, following the sale of shares by Mediobanca to Dreyfus Fund, was "induce[d]" by gratitude for the purchase to permit Dreyfus Marine Midland Management Corporation to manage the investment of certain ITT pension funds. There is no allegation in the paragraph that ITT was motivated by any corrupt purpose, that Dreyfus Marine Midland Management was an inappropriate investment manager for ITT's pension funds, or that Dreyfus Fund was deprived of any corporate opportunity or advantage by ITT. Nothing in the paragraph sets forth with "definiteness and reasonable certainty" the "particular acts of fraud" which ITT is claimed to have committed. Chamberlain Machine Works v. United States, supra at 349.

Moreover, even if it were thought that plaintiff's complaint satisfied the particularity requirement, the complaint fails to comply with the long-settled requirement that allegations of fraud may not be pleaded upon "information and belief." Segal v. Gordon, supra at 608;

2A Moore, Federal Practice ¶ 9.03 (2d ed. 1968). Plaintiff's complaint expressly acknowledges that, apart from the allegation that plaintiff is and has been a shareholder of Dreyfus Fund, all of its averments are founded on information and belief. (A7.) Although plaintiff has claimed that his counsel conducted an "investigation" prior to the filing of the complaint, nothing in the transcript of plaintiff's oral deposition or elsewhere in the record offers substantiation for the claim. Rule 9(b) would be reduced to a mockery if such an unsupported claim were sufficient to satisfy its requirements.[5/]

II.

The District Court properly refused to permit discovery to search for support for the vague and conclusory allegations of the complaint.

Plaintiff claims that the complaint should not have been dismissed until he was afforded an opportunity to conduct elaborate discovery regarding defendants' business activities over a lengthy period. He relies for

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5/ Plaintiff's claim that Rule 8 weakens or overrides the requirements of Rule 9(b) is without substance. It is settled that Rule 9(b) is a "specific exception" to the general provisions of Rule 8. Stuckey v. DuPont Glore Forgan, Inc., 59 F.R.D. 129, 130 (N.D. Calif. 1973).

this purpose upon Schoenbaum v. Firstbrook, 405 F.2d 215 (2d Cir. 1968), cert. denied, 395 U.S. 906 (1969). The claim is without merit.

Unlike Schoenbaum, this is not a situation in which a plaintiff has properly asserted a claim for relief, but has nonetheless been foreclosed from reasonable opportunities to discover supporting evidence for that claim. Plaintiff here has failed to satisfy the threshold requirements of Rule 9(b) for the proper assertion of a fraud claim. He seeks, not redress for injuries suffered as a result of specific wrongdoing, but an opportunity to rummage through defendants' past business activities to search for a wrong. Segal v. Gordon, supra at 607-608; Spiegler v. Wills, supra at 683. The purpose of Rule 9(b) is "to eliminate the type of fraud action in which the facts are learned after the complaint is filed." Goldberg v. Shapiro, supra at 96,717. In the circumstances presented here, the principles announced in Schoenbaum are inapplicable. Spiegler v. Wills, supra at 683.

III.

Plaintiff's refusal to file a more definite statement warranted dismissal without prejudice.

The District Court permitted plaintiff more than five months in which to comply with its order that he file a more definite statement of his claims. In light of plaintiff's obduracy, the District Court plainly did not abuse its discretionary authority under Rules 12(e) and 41(b) by dismissing the complaint without prejudice. Kellman v. ICS, Inc., 447 F.2d 1305, 1310 (6th Cir. 1971).[6/] The dismissal leaves plaintiff entirely free to reinstitute his claims through the filing of a proper complaint. In contrast, if the District Court had

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6/ Plaintiff's claim that the filing of a complaint that satisfied Rule 9(b) would expose his work product and the name of his "informer" is obviously without merit. Rule 9(b) requires particularity in the description of transactions and events that are alleged to constitute fraud, and not the identification of plaintiff's sources of information. In any event, no informer's privilege exists with respect to any of the transactions involved here, and the work product rule is simply inapplicable. Moreover, even if it were assumed that the work product rule may be used to deny defendants reasonable notice of the claims made against them, the rule offers only conditional protection. Discovery of work product materials is permitted under Rule 26(b)(3) whenever a "substantial need" exists. Even if it is assumed that the work product rule may be applicable, the District Court's order that plaintiff file a more definite statement was in substance a determination that such a need exists here, and that defendants are entitled to have knowledge of the allegations upon which plaintiff seeks to rely.

disregarded plaintiff's failure to comply with its order, and permitted plaintiff to conduct elaborate and burdensome discovery, the purposes that Rule 9(b) was intended to serve would have been defeated. Considerations of fairness and sound judicial policy demand that the judgment below be affirmed.

CONCLUSION

The judgment entered below dismissing the complaint without prejudice should be affirmed.

Respectfully submitted,

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Certificate of Service

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